DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0124 RST
Sales and Use Tax
For Years 1991 through 1995

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales and Use Tax –Projection of Prior Audit Results

Authority: **IC 6-8.1-3-17**

The taxpayer protests the projection of prior audit results without modification to current tax years.

II. Sales and Use Tax – PAL Equipment and Leaflets

Authority:

IC 6-2.5-2-1	**45 IAC 2.2-2-1**
IC 6-2.5-5-3(b)	**45 IAC 2.2-5-8**
IC 6-2.5-5-6	

The taxpayer protests the imposition of sales tax on its purchase of items used in its Prescription Access Link (PAL) leaflets.

III. Use Tax – Sensormantic Labels

Authority:

IC 6-2.5-3-1	**IC 6-2.5-4-1(a)(3)**
IC 6-2.5-3-2(a)	**45 IAC 2.2-3-13**
IC 6-2.5-4-1(a)(2)	**45 IAC 2.2-5-8**
45 IAC 2.2-3-3	**45 IAC 2.2-5-8**

The taxpayer protests the imposition of sales tax on its purchase of Sensormatic labels.

IV. Tax Administration -- Penalty

Authority:

IC 6-8.1-10-2.1(a)(3)	**45 IAC 15-11-2(b)**
IC 6-8.1-10-2.1(d)	**45 IAC 15-11-2(c)**
IC 6-8.1-10-2.1(e)	

The taxpayer protests the imposition of the 10% negligence penalty.

STATEMENT OF FACTS

The taxpayer is a corporation licensed to sell prescription pharmaceuticals, health and beauty aids, foods, and miscellaneous other items at retail in Indiana. On March 31, 1994, the taxpayer and another corporation entered into an agreement whereby the successor corporation acquired all of the taxpayer's common stock; the taxpayer became a wholly owned subsidiary of the successor. The transaction was completed on July 14, 1994. The word "taxpayer" will refer to the merged entities.

The current audit (1991 through 1995) resulted in proposed assessments of sale and use tax and a 10% negligence penalty. The taxpayer filed a timely protest and an administrative hearing was held on November 11, 2000. Additional information will be provided as necessary.

I. Sales and Use Tax: Projection of Prior Audit Results: The $ 25,000 Settlement

DISCUSSION

The taxpayer protests the fact that a $25,000 settlement reached for prior tax periods (1988-1990) did not change the projection formula that was subsequently carried forward and used in the current audit period (1991-1995). Taxpayer contends Audit's refusal to modify the projection formula results in an overstatement of taxpayer's current sales and use tax liabilities. The following letter summarizes this prior settlement:

> Thank you very much for your assistance in helping to resolve [the taxpayer's] Indiana Sales and use tax audit. [Taxpayer] agrees to the settlement we discussed on the telephone this morning. It is our understanding that the audit liability will be reduced for (1) sales of food products made pursuant to a doctor's prescription, (2) the average store or department sales discount, and (3) a fixed amount of $25,000 of tax.

The Department agreed to reduce its 1988-1990 assessments of tax on the nutritional supplements sold by taxpayer by $25,000. There is no other documentation in the file regarding the nature of this agreement.

The Explanation of Adjustment accompanying the current audit provides in pertinent part:

> **This audit** will utilize the results of the prior audit as determined in the [1993] Letter of Finding as the best information available for the period 1/1/91 through 1/14/94. In addition, prior audit taxable sales of nutrition supplements

> are reduced for doctors' prescriptions at 12.7% and average sales discounts at 1.3%
>
> * * * *
>
> **This audit** does not allow a requested reduction of $25,000 from prior audit taxable nutrition supplements.

(1997 Audit Summary; emphasis added).

Under IC 6-8.1-3-17(a), the commissioner may settle "any tax liability dispute if a substantial doubt exists as to:

> (1) the constitutionality of the tax under the Constitution of the State of Indiana;
> (2) the right to impose the tax;
> (3) the correct amount of tax due;
> (4) the collectibility of the tax; or
> (5) whether the taxpayer is a resident or nonresident of Indiana.

The $25,000 at issue was a one-time allowance in settlement at the Commissioner's discretion and was intended only to apply to the taxable years 1988-1990. To assume, as the taxpayer apparently does, that the $25,000 one-time settlement should apply to subsequent audit cycles would result in a legal absurdity. The plain meaning of the emphasized phrase "this audit" refers to the current assessments for audit years 1991-1995. The projection of prior audit capital purchases cannot incorporate the $25,000 reduction as there were no specific transactions associated with this amount. The $25,000 settlement simply represented a generalized adjustment to taxpayer's prior nutritional liabilities, nothing more.

FINDING

The taxpayer's protest is denied.

II. Sales and Use Tax- PAL Equipment and Leaflets

DISCUSSION

The taxpayer protests the imposition of Indiana sales and use tax on its Prescription Access Link (PAL) equipment and the leaflets generated when dispensing prescribed medications. The items covered by the tax include toner cartridges, blank leaflet forms, and a laser jet printer. The taxpayer argues that these items are exempt from the tax because they are related to the production of the PAL leaflet; the taxpayer claims the leaflet is part of the prescription drug product sold. The leaflet, containing information on the patient, the medication, directions for use, etc., is stapled to the prescription bag. The leaflet itself is a blank form filled out according to "canned" software on the pharmacy's computer system. Indiana Code Section 6-2.5-2-1(a) mandates the imposition of "the state gross retail tax" on "retail transactions made in Indiana." Similarly, IC 6-2.5-3-2(a) mandates the imposition of the use tax "on the storage, use, or consumption of tangible personal property . . .." Subsection (d)(2) exempts property delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property. . . ." IC 6-2-2.5-3-7(a) establishes a rebuttable presumption of taxability.

The taxpayer argues that the equipment and blank forms at issue fall under the exemptions provided for in IC 6-2.5-5-1 et seq, specifically IC 6-2.5-5-3(b). This section provides in pertinent part:

> Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax **if** the person [the taxpayer] acquiring that property acquires it for **direct use** in the **direct production, manufacture, fabrication, assembly . . . or finishing** of other tangible personal property.

(Emphasis added)

The leaflet is stapled to the prescription bag containing the customer's medications; it is not produced for sale, but merely for the customer's information and convenience.

Exemptions under IC 6-2.5-5-1 and IC 6-2.5-5-6 cover property directly used in the direct production of food or commodities for sale or consumption. The taxpayer is not engaged in the direct production of food and commodities for sale; the taxpayer is a retail merchant. The taxpayer does not produce, manufacture, fabricate, assemble, or otherwise finish tangible personal property within the meaning of the exemption statutes. The taxpayer loads blank forms into a printer, presses a few buttons, and a canned program generates the information printed on the leaflet. These leaflets are not "incorporated as a material part of a product manufactured for sale." Removing the leaflet from the prescription bag does not materially affect any of the medications sold.

Similarly, to the extent the laser jet printer and the toner cartridges are used to create these leaflets, the printer and cartridges are not used in the "direct production of tangible personal property."

FINDING

The taxpayer's protest is denied.

III. Use Tax- Sensormatic Labels

DISCUSSION

The taxpayer protests the assessments of use tax on its purchase of Sensormatic labels. According to the taxpayer, Sensormatic labels are purchased for the purpose of reselling them as part of the product they are affixed to.

The Department disagrees. These labels are in reality inventory tags attached to merchandise to aid the taxpayer in detecting attempted thefts from their stores. They are magnetic security devices that the sales clerk at the cash register demagnetizes so the customer may exit the store without setting off the alarm. As such, the labels are part of a security system and do not fall within the ambit of the exemptions outlined in IC 6-2.5-5-3 or IC 6-2.5.5.5.1

FINDING

The taxpayer's protest is denied.

IV. Tax Administration- Penalty

The taxpayer protests the Department's imposition of the 10% negligence penalty.

Indiana Code 6-8.1-10-2.1(a)(3) authorizes the Department to impose a penalty on a taxpayer if he "incurs, upon examination by the department, a deficiency that is due to negligence." Subsection (d) provides in pertinent part:

> If a person subject to the penalty imposed under this section can show that the failure to . . .pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department **shall** waive the penalty.

(Emphasis added)

Indiana Administrative Code, Title 45, Article 15, Rule 11-2(b) provides in pertinent part:

> "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

In determining whether or not to assess the 10% penalty, the Department looks for indicia of negligence as well as indicia of due diligence. Under IC 6-8.1-5-4, the taxpayer has an affirmative duty to maintain "books and records so that the department can determine the amount, if any, of the person's liability by reviewing those books and records." Since the taxpayer did not use reasonable care or caution in maintaining the predecessor's records during its acquisition by the successor, negligence has occurred under 45 IAC 15-11-2(b).

The taxpayer has not met its burden of affirmatively demonstrating that its failure to pay its tax deficiency "was due to reasonable cause."

FINDING

The taxpayer's protest is denied.

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